United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

74-2625

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P/S

UNITED STATES COURT OF APPEALS

For the Second Circuit.

Docket No. 74-2625

ARTHUR L. STAIR and BERNICE STAIR,

Plaintiffs-Appellants,

vs.

UNITED STATES OF AMERICA,

Defendant-Appellee.

On Appeal From the United States District Court for the Northern District of New York

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BRIEF FOR APPELLANTS, ARTHUR L. STAIR and BERNICE STAIR

Stearns & Stearns,
Attorneys for Plaintiffs-Appellants,
507 Press Building,
Binghamton, N.Y. 13902

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BRIEF FOR APPELLANTS, ARTHUR L. STAIR and BERNICE STAIR

Statement of Issue Presented.

By their mere execution of an administrative Form 870-AD (and not a statutory final closing agreement), are the taxpayers equitably estopped, the statute of limitations having run against any further government assessment, from seeking a refund of collected taxes?

Statement of the Case.

The plaintiffs -appellants-taxpayers seek a refund of taxes in the amount of $39,502.54, plus interest, alleged to have been illegally and

erroneously collected. The underlying substantive question is that of "ordinary income versus capital gains". In the United States District Court for the Northern District of New York, Judge Port, finding the taxpayers estopped from seeking a refund by their having executed a Form 870-AD, granted the defendant-appellee-government's motion for summary judgment and dismissal. This is an appeal from the judgment so entered.

Statement of Facts.

The Stairs herein seek a refund (6a*) of income taxes in the amount of $39,502.54, plus interest, alleged to have been illegally and erroneously collected for the year 1964.

As sole proprietor of "Stair Builders", Mr. Stair's business in 1964 was primarily the development, improvement and construction of housing subdivisions for the sale to the general public of individual, single-family residences. The taxpayers' joint federal income tax return for 1964 was duly filed with the appropriate District Director of Internal Revenue on or before April 15, 1965.

Upon audit of the taxpayers for 1964, the Internal Revenue Service determined, among other things, that the gain from the condemnation of a certain 95.396 acre parcel of land was ordinary income and not capital gains (23a). The resulting proposed deficiency, in the amount of $83,065.69, was almost entirely attributable to said determination (23a).

The taxpayers engaged the services both of Harry Bangilsdorf, an attorney and certified public accountant, and of Abraham L. Piaker, a certified public accountant, to represent them before the Internal Revenue Service in connection with the proposed deficiency (23a). After filing a protest on behalf of the taxpayers during July of 1966, Messrs. Bangilsdorf and Piaker met with an Internal Revenue Service

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*Numbers in parenthethis refer to pages of the Appendix.

Appellate Division conferee, Mr. Robert J. Lyden, in August of 1966 (23a). At that conference several legal and factual matters were discussed and various settlement proposals were put forth by Messrs. Bangilsdorf and Piaker. No settlement was reached and their representatives recommended to the taxpayers that the matter be litigated (23a).

Thereafter, arrangements were made by Mr. Stair personally for a conference with Mr. Lyden, this one involving only Mr. Stair and not including either of his two representatives, although those two representatives were aware that such a conference was being scheduled (24a). Mr. Stair and Mr. Lyden met in October of 1966 to discuss the case further and to explore settlement possibilities. After much discussion, it was proposed that the case be settled on the basis of an approximate 50/50 split (i.e., consider 50% of the gain as long-term capital gain and the remaining 50% thereof as ordinary income). Mr. Lyden advised Mr. Stair that he (Lyden) would recommend acceptance of the settlement proposal (24a).

Shortly after that conference between Mr. Lyden and Mr. Stair, Mr. Lyden telephoned Mr. Stair to advise that his (Mr. Lyden's) supervisor would not approve the settlement arrangements which the two had concluded. As a result of this telephone call, a substitute settlement understanding was arrived at between Mr. Lyden and Mr. Stair under which there would be an approximate 50/50 "tax" split (i.e., roughly 50% of the deficiency as originally proposed). This substituted settlement arrangement proved to be acceptable to Mr. Lyden's supervisor and the Government (24a).

During November of 1966 a Form 870-AD ("Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment") was forwarded by Mr. Lyden to the taxpayers

who executed the document and returned it to Mr. Lyden (9a). Subsequently, in the same month, the offer was duly accepted (executed) on behalf of the Government. The settlement set forth in the Form 870-AD contemplated a deficiency assessment in the amount of $41,420.54, which amount, together with appropriate interest thereon, the taxpayers paid to the Internal Revenue Service on December 30, 1966 (25a).

On August 22, 1968 the case of Commissioner v. Tri-S Corporation, 68-2 USTC §9541, was decided by the United States Court of Appeals, Tenth Circuit (6a). Thereafter, Mr. Bangilsdorf advised Mr. Stair that said case's decision and opinion supported his (Mr. Stair's) position vis-a-vis the condemnation and resultant ordinary income versus capital gains issue (15a). Upon counsel's advice, the taxpayers on November 25, 1968 duly filed a Form 843 claim for refund of $39,502.54 (plus appropriate interest thereon) of the $41,420.54 paid by them on December 30, 1966 (15a, 25a). The principal amount of $39,502.54 represented that portion of the deficiency attributable to the issue of ordinary income versus capital gains (25a). On their Form 843 claim for refund the taxpayers specifcially called attention to the recently decided Tri-S Corporation (15a). On March 19, 1969 the Internal Revenue Service advised the taxpayers of its rejection of their claim for refund and thereafter this action was instituted (25a, 3a).

POINT

The taxpayers' mere execution of an administrative Form 870-AD and the running of the statute of limitations against any further government assessment do not estop the taxpayers from seeking a refund of collected taxes.

It is settled law that only by use of an Internal Revenue Code §7121 "final closing agreement" can an I.R.S. tax settlement be made

binding. Botany Worsted Mills v. United States, 278 U.S. 282, 288 (1929), 1 USTC Par. 348. Congress has provided no other means. Morris White Fashions v. United States, 176 F.Supp. 760, 60-1 USTC Par. 9146 (S.D.N.Y. 1959).

The Internal Revenue Service purports to accomplish that same statutory finality by use of various administrative forms, including the Form 870-AD like that (9a) executed by the taxpayers in the instant case. The Form 870-AD itself states that it is not a final closing agreement (9a) and it is settled that, standing alone, it is not binding.

> A literal reading of Form 870-AD signed by plaintiffs would conclusively support the Government's position. The Form provides that:
>
> > If this proposal is accepted by or on behalf of the commissioner. . .no claim for refund or credit shall be filed or prosecuted for the year(s) above stated. . . /emphasis added/.
>
> Nevertheless, there is a hoary line of cases holding that the taxpayer's promise is not binding, primarily on the ground that only a formal closing agreement or compromise could make it so. See, e.g. Uinta Livestock Corp. v. United States, 355 F.2d 761, 765, (2d Cir. 1965). . . The rule has withstood the criticisim of eminent authorities, see e.g., Griswold, Finality in Administrative Settlement in Tax Cases, 57 Harv.L.Rev. 912 (1944). . .Lignos v. United States, 439 F.2d 1365, 71-1 USTC Par. 9302(2d Cir. 1971).

But Botany Mills left open the question whether, under certain circumstances, taxpayers who had not been parties to a statutory agreement might nevertheless be estopped from tax refunds. The pertinent cases since Botany Mills demonstrate that each case must be decided on an individual basis. D.D.I., Inc. v. United States, 467 F.2d 497, 72-2 USTC Par. 9703(Ct.Cls. 1972).

In Guggenheim v. United States, 77 F.Supp. 186, 48-1 USTC Par.

9232(Ct.Cls. 1948), cert. denied, 335 U.S. 908, rehearing denied, 336 U.S. 911(1949), it was held that an estoppel arose where, between the time an informal compromise agreement was executed and a refund claim was filed, the statute of limitations had run against the collection of further deficiencies.

> It would be inequitable to allow the plaintiff to renounce the agreement. . . (since) the Commissioner cannot be placed in the same position he was when the agreement was executed. Id.

However, as pointed out by the successful taxpayers in Morris White Fashions, supra, Guggenheim ignored the fact that

> the defense of equitable recoupment may be pleaded by the Government as a set-off to plaintiff's claim for refund, even though the statute of limitations has run against the Government. Such a defense is never barred by the statute of limitations, so long as the main action is timely. To allow the prosecution of the refund to stand while simultaneously permitting the Government to plead a set-off against such a claim appears to be the more reasonbale approach to the problem of adjusting tax controversies, and has in fact been adopted by the Second Circuit and other jurisdictions. Morris White Fashions, supra.(citations omitted).

See also Speciality Leather Goods Co., Inc. v. United States, 64-2 USTC Par. 9656 (S.D.N.Y. 1964) (doctrine of equitable recoupment allows government to effectively off-set a claim for refund after an 870-AD settlement by initiating a counter-claim for deficiencies in the full amount of plaintiff's claim, leaving both parties where they were at the time the settlement was agreed upon).

The basic principles underlying the doctrine of equitable estoppel as applied in tax compromise cases were set forth in Van Antwerp v. United States, 92 F.2d 871, 875, 37-2 USTC Par. 9553 (9th Cir. 1937).

> To constitute estoppel (1) there must be false representation or wrongful misleading silence.

> (2) The error must originate in a statement of fact and not in an opinion or a statement of law. (3) The person claiming the benefits of estoppel must be ignorant of the true facts, and (4) be adversely affected by the acts or statements of the person against whom an estoppel is claimed. Cain v. United States, 255 F.2d 193, 58-1 USTC Par. 9476 (8th Cir. 1958) (VanOosterhout, J., dissenting), citing VanAntwerp, supra.

In Morris White Fashions, under circumstances analogous to those of the instant case, the court (S.D.N.Y.) failed to find any "false respresentation or misleading silence upon which the Government could possibly rely". Since the Government admitted it knew the administrative settlement did not constitute a binding closing agreement (indeed, as noted supra, a statement to that effect is found on the 870-AD itself), the Government could not be said to have detrimentally relied; insofar as the taxpayers agreed not to prosecute a claim for refund, the administrative agreement was found to be a nullity. Morris White Fashions, supra.

On occasion the Government has successfully raised the defense of estoppel. Cooper Agency v. United States, 301 F.Supp. 71, 69-2 USTC Par. 9560 (S.C. 1969), aff'd per curiam, 422 F.2d 1331, 70-1 USTC Par. 9321; General Split Corp. v. United States, 363 F.Supp. 313, 73-2 USTC Par. 9647 (E.D.Wisc. 1973), aff'd 500 F.2d 998, 74-2 USTC Par. 9576 (7th Cir. 1974). It is emphatically asserted, however, that the instant case is factually distinguishable from both Cooper Agency and General Split.

Cooper Agency involved a "package deal" wherein a settlement agreement was made on behalf of the plaintiff and some 14 other persons and corporations. In reliance upon the taxpayers' agreement not to seek refunds, the Government permitted the statute of limitations to run with respect to further claims against each of the 15

taxpayers and as to some, abandoned proceedings in the Appellate Division and consented to adverse decrees in the tax court. With only the plaintiff suing for a refund, the Government had no right of recoupment against the 14 other taxpayers embraced in the settlement. Accordingly, sufficient prejudice was found to support an estoppel.

The court in General Split, supra, considering all the circumstances of that case, held the taxpayer estopped to assert its refund claim. The parties had negotiated an integrated three-part package settlement of all the assessed deficiencies. It included (1) a stipulated tax court decision regarding three of the taxable years in question, (2) the execution of a "collateral agreement" as "an integral part of the proposal for settlement" of the tax liabilities for the other two years "and as additional consideration for the acceptance" of the settlement by the Commissioner, and (3) the execution of a Form 870-AD regarding the taxation of certain trust loans within the same other two years.

> (W)hen the time for appeal had expired, the portion of the settlement affected by the Tax Court decision became final and could not be set aside or reviewed. At that point a large part of the consideration furnished by the Government for the package deal was beyond its reach. The taxpayer seeks to litigate the question of appropriate taxation of the trust loans even though the Government is now able to recoup by set-off at best only the asserted tax liability for the (other two taxable years). Id., 500 F.2d 998 (citation omitted).

> The taxpayer has not suggested here or in the District Court that the Government would have agreed to a stipulation in the Tax Court litigation regardless of any settlement agreement for (the two tax years). The parties...were bound at the time a Tax Court decision became final. At that juncture, considering the nature of the settlement,

there was no equitable way to undo the portion of the settlement reflected in Form 870-AD. Id.

Finally, this Court in Lignos, supra, has considered many aspects of the instant issue. The defendant-appellee has previously asserted that Lignos supports its position. Clearly it does not. Lignos merely held that the Discrict Court had improperly granted the Government's motion for summary judgment where clear-cut issues of fact remain. Admittedly, this Court did apparently approve and adopt the VanAntwerp four-elements test; it was thereby able, on remand, to indicate to the trial court the key questions of fact for resolution. But it made no finding regarding what factual circumstances would constitute, for example, a "wrongful misleading silence".

Assuming arguendo that Lignos supports the Government's position, the instant case is factually distinguishable. As noted by this Court, the Lignos taxpayers obviously "played their cards close to the vest". Faced with Tax Court litigation regarding a 1961 deficiency and civil fraud penalty, and similiar deficiencies and penalties for 1962 and 1963, they negotiated with the Government and achieved a "package settlement". In return for the taxpayers' agreement to pay a very high percentage of the 1962 and the 1963 deficiencies and penalties (still designated civil fraud) and their execution of a Form 870-AD as to those years, the Government agreed to stipulate judgment in the tax court action. The 1961 deficiency was greatly reduced and the civil fraud penalty was changed to one based on negligence and, in amount, all but eliminated. Then, only two months after the tax court decision became final, the taxpayers filed claims for refund of the tax and penalties paid for the other two years

involved in the package deal. A clear inference arises that the Lignos taxpayers at all times and including the day they signed the Form 870-AD fully intended to file refund claims for the years 1962 and 1963 after making hoped concessions regarding those years in order to obtain a very favorable judgment in the tax court action.

In contrast to Lignos, General Split, and Cooper Agency, the instant case has involved no attempt to repudiate concessions made as part of a package settlement, no misrepresentation, and no misleading silence. Appellants respectfully disagree with the district court's observation (37a) that Mr. "Stair was playing the card close to his chest", or that the taxpayers practiced (39a) a "studied silence" after the statute of limitations on assessment had run".

The record clearly demonstrates (1) the straightforward manner in which Mr. Stair conducted himself, (2) the circumstances surrounding the taxpayers' execution of the Form 870-AD, and (3) the reason the taxpayers filed a claim for refund when they did.

Mr. Stair has testified that he negotiated with Mr. Lyden openly and honestly (13a, 14a). Mr. Lyden has confirmed that no deception or bribery of any sort was at any time attempted by Mr. Stair or his representative (17a, 18a, 19a, 20a), nor did they ever make any representation which turned out subsequently to be untrue or half-true (19a). "Mr. Stair was a real gentlemen. He was very much to the point." (19a).

Mr. Stair's purposes were to avoid loosing his land by condemnatation and loosing the gain in taxes, but to avoid litigation, too (13a). He knew that Mr. Lyden "knew a lot more about it" then he did (13a), and he relied on what Mr. Lyden said in connection with the

respective merits of each side of the dispute (14a). Mr. Lyden himself could later not recall whether at his conference with Mr. Stair he (Lyden) had shown Mr. Stair the Form 870-AD or explained its operative effect (20a). Mr. Stair executed the 870-AD without fully reading it because Mr. Lyden mailed it to him to be signed and he (Stair) felt he could trust Mr. Lyden (11a).

Most importantly, when Mr. Stair signed the 870-AD "it never entered (his) mind" that it precluded him from ever filing a claim for refund (11a). Since at that time the taxpayers had no idea that such an option existed, they hardly could have misrepresented themselves or mislead the Government as the Lignos taxpayers apparently did. As far as the taxpayers were concerned at the end of 1966, the matter had been settled. Only upon Tri-S Corporation's being handed down and upon their counsel's advice (15a) did the taxpayers months later decide to file a refund claim.

It is seen that the taxpayers practiced no fraud upon the Government. If the Government persists in claiming otherwise, it can clearly so allege within a counter-claim for equitable recoupment. But where an agency is fully aware that the administrative settlement accomplished was not and cannot be held to be binding, the law does not direct and it should not be held that the taxpayers' claim for refund be "equitably" estopped, even if the statute of limitations has run against the Government. Again, the doctrine of equitable recoupment "protects" the Government. Assuming arguendo that it does not, the Government knows what it is doing in these cases. If it has resolved to make admittedly non-binding settlements while knowing that taxpayers can, even after the running of the statute, file claims for refund, then it has voluntarily chosen to run such

risks in exchange for whatever advantages it reaps in the long run in the overwhelming number of other cases "finally" settled by non-statutory means.

But to hold the taxpayers estopped under the circumstances of this case is to do that which the Congress has not done, that is, make the administrative settlement agreement the equal, in all respects, of a statutory final (formal) closing agreement. Uinta Livestock, supra. The appellants respectfully submit that this cannot and should not be done.

CONCLUSION.

It is not the taxpayers who should be estopped to bring this action but, rather, it is the Government which should be estopped from preventing the taxpayers from bringing to the district court, for appropriate resolution, the ultimate substantive issue involved. This Court is requested to reverse the judgment below so that the case may proceed.

Respectfully submitted,

STEARNS & STEARNS
By: Paul E. Pool, Esq.
Attorneys for Plaintiffs-Appellants,

507 Press Building,
Binghamton, New York 13902

STEARNS & STEARNS
ATTORNEYS AT LAW
507 PRESS BUILDING • P. O. BOX 1964
BINGHAMTON, NEW YORK 13902
TELEPHONE (607) 723-9481

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DATE 2/21/75

SUBJECT Stair v. USA
Docket # 74-2625

Dear Sir:

Please find enclosed an original and 3 copies of our Motion for an Extension of Time to File the Brief and Appendix, w/ attached Affidavit in Support. Proof of Service of our Appendix; 25 copies of the Appellant's Brief; and Proof of Service of the Brief and the Motion Papers upon opposing counsel. I understand that 10 copies of the Appendix have been received by you.

Sincerely, Paul E. Pool

Form ML4-N72 The Drawing Board, Inc., Box 505, Dallas, Texas

STEARNS & STEARNS

ATTORNEYS AT LAW
507 PRESS BUILDING • P. O. BOX 1964
BINGHAMTON, NEW YORK 13902
TELEPHONE (607) 723-9481

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DATE February 12, 1975

SUBJECT Stair v. U.S.A.
Index No. 74-2625
Appendix

Greetings:

We enclose for filing ten (10) copies of the Appendix in our appeal of the above-entitled case.

Very truly yours,

STEARNS & STEARNS

By: Paul E. Pool
Legal Assistant

PEP:pam
Encs.